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PROMOTION BEFORE THE TRUSTS.

THE recent course of industrial enterprise is so clearly identified with those great industrial and financial combinations known in a general way as trusts that all the phenomena accompanying a period of prosperity and rising prices are also, in the public mind, more or less identified with them. The slightest reflection or acquaintance with the history of industry, however, makes manifest that this connection is not in all respects a necessary one. It may be that the recent appearance of what we may call the organic or spontaneous rise of prices due to credit movement, in spite of the fact that the world's supply of gold has been cut in two by the Boer war, is more extensive, and therefore more important, than any that has occurred before, and that indirectly some connection may be found between the inflation and the contemporary practice of industrial combination. But it is apparent to anyone who thinks of the days of the "South Sea Company" and the "Mississippi Bubble," and of the recurring periods of inflation that have intervened between that time and the present, that inordinate overcapitalization in the epochs preceding the great combinations has occurred, causing an undue inflation of future values and rise in present prices, in the complete absence of any considerable combination.

To discover the cause of inflation and high prices we must turn from monopoly to overcapitalization. The crisis of 1873 has been selected, as one that occurred distinctly previous to the era of industrial combination. The general course of that crisis will be followed so far as seems necessary to emphasize the presence of stock-watering and the absence of combination.

The course of prosperity is always marked by preliminary crises. At first these are insufficient to arrest the general development. If severe, they are local; if general, they are mild. The broken obligations are at first easily met by strong creditors who make up the deficiency out of surpluses from other investments. The incident is forgotten in the general pushing forward of large

business engagements and in the increasing production. In a year or two, however, weak spots again develop, this time in more numerous localities; or else a general reaction occurs, which is more pronounced. Then follows a new period of activity and production. The recurring reactions, however, become more severe and more general. It becomes hard to distinguish between local distress and general inconvenience until the final crisis is recognized by a general breakdown throughout the world of commerce, industry, and finance.

There was a crisis in England in 1866 signalized by the failure of Overend, Gurney & Co. A pronounced forerunner of the crisis of 1873 is noticeable in Austria-Hungary as early as 1869. It was especially in the kingdom of Hungary that the most reckless speculation took place. Undigested securities, speculators abandoned by the banks, disquieting political rumors from Paris, made the public conscious that speculation had gone too far. In Belgium also, a country which still preserves the ties which have united it to Austria from very early times, an adventurer named Langrand Dumonceau worked with great success the well-known game of the swindling land bank, the Catholic Bank, and deceived large numbers of Austrians as well as his own countrymen, although at the cost to himself of twenty years in the penitentiary.¹

In the United States there had been a "Black Friday" in 1869; and in October, 1870, in order to relieve a stringency in Wall Street, Mr. Boutwell, who had succeeded Mr. McCulloch as secretary of the treasury at the beginning of President Grant's administration, issued \$1,500,000 legal-tender notes. In 1872, in spite of the criticism on his former conduct, he issued \$4,637,256 more legal tenders, although he speedily retired most of them under the fire of public opinion; and when the crisis finally came, beginning with the failure of the New York & Oswego Midland Railroad Co. on September 8, his successor, Mr. Richardson, made further issues.²

¹ WIRTH, *Geschichte der Handelskrisen*, pp. 464, 617.

² BOLLES, *Financial History of the United States*, Vol. III, p. 282; WHITE, "The Financial Crisis in America," *Fortnightly Review*, Vol. XXV; WIRTH, *op. cit.*, p. 544.

Coming down in Europe closer to 1873, we find that the development of speculation in Austria and Germany went hand in hand. The Austrian securities found a wide market in Germany. In fact, Germany was the country in which speculation was the most widely spread, if not the most acute and intense. Every general liquidation in business paves the way for a new period of investment. It makes no difference whether the liquidation be apparently organic—that is, whether it be simply the process of settling and satisfying of claims after general business disaster—or whether it be an artificial liquidation arising from action of government, such as the payment of loans with moneys received from a war indemnity. In 1903 the promotion was more purely stimulated by the organic liquidation which preceded, while in 1873 the war indemnity was added to the organic liquidation. Notwithstanding the fact that the payment of nearly six billion francs by France to Germany was so well managed as to cause little disturbance in the exchange market, there were, nevertheless, results that seriously affected the distribution of capital in Europe; for, to the extent of the amount above named, capital in the form of goods, money, industrial power, financial promises, or “obligations” was transferred from France to Germany. This capital sought new investment. It was so much material for a crisis. To the extent of this capital the French were relieved of crisis stuff and passed it over to the Germans. The French were protected from fever by prophylactic blood-letting. To the same extent the Germans suffered from hypertrophy, indigestion, and overstimulated circulation. The crisis did not start in Germany itself, but in Austria. The mass of the capitalists preferred to put their savings in old and new railroad enterprises, both in Germany and in the United States, but more especially in Austria-Hungary, whither nearly two hundred and fifty million dollars of foreign capital flowed from 1871 to 1873.³

The spirit of inflation is contagious. The German government, though it was attempting to go to a hard-money basis and to the gold standard, actually took steps toward inflation by continually injecting newly minted gold coins into the circulation.

³ WIRTH, *op. cit.*, p. 457.

while it failed to withdraw silver rapidly enough. The suspension of specie payments in the United States and Austria at the same time added to the general world-inflation. The fact that Germany was paying off her domestic loans would anyhow have created a general feeling of ease in money matters, and did doubtless help to conceal the inflation that was really fostered by the government, which should have repressed it. It is well known that the exchanges became unfavorable in Germany after the payment of the French indemnity, and that considerable gold returned to France. This result probably was unavoidable, but was hastened by official inflation in Germany and contraction in France.

The payment of the French indemnity was after all but the change of industrial control from hand to hand. It may be that the new "captains of industry" were to some extent surprised by the honors thrust upon them and at a loss where to place investments, and thus became easy prey to schemes for quick enrichment. It must be admitted, however, that the capital left by war's ravages would unavoidably have sought investment somewhere, and there is nothing to prove that it would ultimately have settled in different enterprises from those whither it actually went. If the financial control had remained with France, the French themselves might have invested in German, Austrian, and American railroads and factories. Some receptacles for investment had to be provided by the course of industrial progress, independently of the apparently artificial changes of wealth through the fortunes of war.

The first new receptacle was Austria-Hungary, the natural country of Europe to receive the next impulse for railroad-building. Its agricultural product, then as now, was exceeded in Europe by those of Russia, France, and Germany alone. Its production of grain per capita exceeded that of the others slightly. Its means of transportation hitherto had been less developed than those of other countries of no greater size; but from 1860 to 1870, while the mileage of the United Kingdom increased some 50 per cent., and that of France and Germany some 65 per cent., that of Austria increased over 100 per cent.; and from 1870 to 1880, while the United Kingdom increased its mileage 10 per cent.

and France 50 per cent., Germany and Austria both doubled theirs. Thus we see plainly the direction in which railroad investment went—first Austria alone, and then Austria and Germany together. So far as concerns railroads, then, Austria was the natural place in Europe for the outbreak of the crisis; and Germany could hardly have expected to progress into the larger environment to come, without also passing through the general course of financial readjustment.

In Austria alone, from 1867 to 1873, 1,005 stock companies were chartered, with a capital of four billion gulden. Of these only 516, with a capital of a billion and a half gulden, survived the year 1874. The actual paid-up capital of those that failed or liquidated was 360 million gulden. Comparing 1866 with 1872, the banking capital of Austria rose from 190 to 508 million gulden; and in the four months before the crisis of 1873, fifteen new banks were founded, with a paid-up capital of 72 million gulden. Between 1866 and 1873 the paid-up railroad capital increased from 506 to 937 million gulden, and the bonds increased from 545 to 1434 million gulden.⁴

In North Germany, in 1871, 265 companies were founded, with over a billion marks capital, of which much more than half was in banks and railroads. In 1872 companies were founded for a billion and a half marks, in which banks, railroads, and building and land companies stood for a half. The promotions for all the world for the year 1872 were estimated at 12.6 billions of francs, of which the largest part naturally went to France on account of the war loans. Outside of France, the largest investments were in America, England, Germany, Austria-Hungary, Turkey, Russia, and Italy, in the order mentioned. The two years 1871 and 1872 absorbed twenty billions of francs. In 1871, however, four-fifths of the investments were in state loans, while in 1872, in spite of the continuance of the French government loans, the majority of the investments were in private industry, especially in railroads and manufacturing.

In Prussia from 1790 to 1867 only two or three stock companies were founded each year, and from 1867 to 1870 the yearly

⁴ *Ibid.*, p. 466.

average increased only to eighteen, while in 1871, 259 were founded, and in 1872, 504. In the first half of 1873 the speculation kept up with seven and a half billion francs of new capital for the world, of which America took 4.3 billions, Germany a billion, Great Britain a billion, and Austria a half billion.

In the United States in 1873 the total railroad mileage was estimated to have cost 1.9 billion dollars, of which 1.1 had been invested since 1857. The Germans had already invested many hundred million dollars⁵ in America by 1857, and during the Civil War they showed their confidence in the success of the North by large investments in Union bonds and earned millions thereby. But the confidence won for American investments by the fidelity with which the government bonds were paid was transferred to the much less deserving American speculative paper. The bonds were gradually paid off or sold back by Germany to America at a profit, and the proceeds reinvested in American railroad stocks. The ten million Germans living in the United States acted as so many agents to promote investment in America among the teeming millions still dwelling in the Fatherland. American agents swarmed in English, German, and Swiss cities which possessed stock exchanges, and pushed railroad securities upon those markets. The American railroads were started with practically no capital. For construction they relied wholly upon bonds.

The crisis of 1873 was, of course, closely connected with the change in the wheat area, but it can hardly be said to have been caused by American exports of grain. The American farmer had not as yet quite driven the European peasant out of the grain market. The process of exclusion was going on, doubtless, but its acute stage cannot be placed earlier than 1875, while its climax was reached in 1880 and 1881. The phenomenon that we have witnessed in 1873 was rather that the grain-carrying roads did not as yet pay. Since the American railroad was built on bonds, the stock issued amounted to an overcapitalization to that extent. In Austria the railroads were also built for the transportation of grain, just as in the United States, and since the speculation in

⁵ *Ibid.*, p. 496.

the former country was also largely in railroads, and the crisis broke out there six months earlier than it did in the United States, we cannot describe it as specially located in new countries. It is true that Austria, like the United States, had large agricultural interests, but it was far from being a new country, so that the aspersion of Sir Robert Giffen's essay "Why the Depression of Trade is so Much Greater in Raw Material Producing Countries than in the Manufacturing Countries"⁶ carries no implication against new countries.

Certainly, much less money was invested in new enterprises in America than in Europe, and whether, on the whole, the American investments were less calculated to bring in returns within a reasonable time is doubtful. In 1871-72 Austria-Hungary created only 400 stock companies, against Prussia's 780 for the same year. The real causes of the crisis, as between the two countries, were perhaps in Germany rather than in Austria, and accompanied the foundation of the new German empire. The Austrian empire had received a new form in 1868, and in that country it was rather the good crops of that year which started the Austrians into speculation in railroads, coal mines, iron and steel furnaces, sugar factories, and banks. In Pesth at the beginning of 1868 there were only 21 stock companies, with a capital of barely 30 million gulden, while by September of the next year 91 companies, with a capital of 327 million gulden, were applied for, and in Vienna, by May of the same year, enterprises amounting to 922 million gulden were announced. Europe, and especially Germany, indeed made great investments in American railroads. Out of a total of 12.6 milliards of francs invested in the world in the year 1872, two milliards are put down for the United States, nearly as much for Austria, and nearly three-fourths as much for Germany and Great Britain severally. In other words, the investment in Europe, not to speak of the state loans taken by France, were perhaps four times as great as those in the United States.

The crisis broke out in Austria simply because speculation was most developed there. After visiting Russia and Italy, it came to the United States, also a seat of great speculation. Austria and

⁶ GIFFEN, *Essays in Finance*, First Series.

the United States, moreover, had a forced circulation of government money; and a fluctuating standard of value is the greatest known incentive to speculation of the gambling sort. The premium on gold in New York was still a fluctuating one in the year 1873, when the lowest was 6.8 per cent. and the highest 19.8 per cent. Of course, this fluctuation was not so great as in earlier years, but then capital was absorbed by the war, whereas now it was gradually liberated for private industry; and the gamblers in the gold market, now finding themselves somewhat hampered by the diminution of the fluctuations in that market, sought another for their operations.⁷

Looking back from the harder experiences of 1875 and 1878, the English did not regard 1873 as a year of crisis. During the Franco-Prussian war British trade had attained its greatest prosperity up to that time. The withdrawals of gold to Germany in 1871 and 1872 had tended to prevent the crisis in England. Undoubtedly there was a large amount of promotion. Comparing the joint-stock companies formed in England in 1870 with those in 1872, we have—

Year	Companies Formed	Pounds Capital
1870.....	584	38,000,000
1872.....	1,116	130,000,000

From 1871 to 1873 the increase in the price of pig iron was 104 per cent.; bar iron, 56 per cent.; iron rails, 61 per cent.; and coal,⁸ 113 per cent. The period was unquestionably one of boom, and some rottenness was disclosed; but the chief characteristic of the speculation in question was the investment in foreign government loans. Giffen⁹ prophesied truly that the next era of speculation would be characterized by the formation of trusts to distribute risks.

In 1870 and 1871 the English public made the following

⁷ MR. HORACE WHITE denied that government paper inflation was a cause of the crisis of 1873 (*op. cit.*).

⁸ LEVI, *History of British Commerce*, p. 496.

⁹ "The Liquidations of 1873-76," *Essays in Finance*, First Series (1877).

loans: 10 million pounds to France in 1870; 80 million pounds to France in 1871; 54 millions to Russia; 44 millions to Turkey; besides loans to Buenos Ayres, Chili, Peru, Honduras, Bolivia, Uruguay, and Paraguay. The British public was not spared the general delusion of enormous expected profits. It was estimated that the total world's investments of all sorts—city, municipal, railway, industrial, credit companies—amounted in 1872 to 505 million pounds, and in 1873 to 624 millions. In fact, in 1875 the English government itself purchased of the khedive of Egypt the shares in the Suez Canal. London had supposed itself unassailable, but the bank crisis in America in September and October, 1873, as well as the large imports of wheat from America, drew gold and sent up the bank rate. Finally a regular panic took place in London on November 19. On November 6 the discount rate had been raised to 9 per cent. on account of the fall of the reserve by 234,000 pounds. On November 8 the fall of stock was less, and it was thought that there was no great danger. The trouble was that France, Germany, and America called for the reserves at the same time. It was a money panic rather than a crisis, but complicated, of course, with the bad news from the American railroads. While there was no severe crisis in England in 1873, yet the conditions were present which continued to undermine English business during the following years. Indeed, Wells goes so far as to say: "Production, employment, and profits at such manufacturing centers as Birmingham and Huddersfield were above the average until 1875."¹⁰ After the crisis was over, the London *Economist* estimated the amount of bonds and the floating debts which were left undisposed of in the hands of the great banking houses at 180 million pounds sterling. Of this, 170 millions were on account of France.¹¹

The manifest destiny of American railroads had much to do with setting the speculators crazy on the continent of Europe. The Union Pacific Railroad was completed earlier than expected and seemed to be a creation of magic. The money for the road was obtained partly by the bonding of the towns and counties through which it passed. The enterprise being launched in this

¹⁰*Recent Economic Changes*, p. 6.

manner, immigration was forced along the line of the road by a systematic process of solicitation in Europe.

While our soldiers were running the enemy before them, the bourse was running up the quotations; while the French prisoners were covering Germany like a flood, the bourse was flooding the country with foreign securities. At first it introduced American railway bonds one at a time, the subsequently so disreputable Alabama-Chattanooga, Oregon and California, Georgia Aid, Port Royal, Peninsula, Rockford, Rock Island, etc., twenty-six in all. They could not be sold in America, and so the Fatherland had to be blessed with them, and, in fact, they were mostly sold there. When introduced at Berlin and Frankfort they were quoted at from 70 to 90, and today (1876) they average 10 to 20, because most of them pay interest no longer. These railroad bonds were mistaken by many for United States bonds, a government security which had maintained its reputation.¹²

The more immigrants that settled along the lines of road, the more ties were created with the Old World, which drew further immigration or investment in securities. The same process was followed in the construction of all the transcontinental roads in America, and it partially explains why these roads were built with bonds and not with stock. The European investors were accustomed to American government bonds, and it was an easier step for them to railway bonds than it would have been to railway stock. Another reason for financing the roads on bonds was that the stock, and with it the control and management of the roads, remained on this side of the Atlantic. But by the year 1870 the amount of American securities placed in Europe was already estimated in London at a billion dollars.¹³ By January 1, 1876, \$789,367,665 American railroad bonds were in default, of which \$253,400,000 were held abroad.¹⁴

The fact that the American railroads built upon capital borrowed in Germany, Holland, England, and other European countries were not able to pay dividends at once was a cause of great weakness in the situation in Europe. The indebtedness of the United States to Europe on railway account was also a cause of weakness at home; in fact, this country was involved in enter-

¹¹ WIRTH, *op. cit.*, p. 587.

¹² GLAGAU, *Börsen und Gründungs-Schwindel in Berlin*, p. 18.

¹³ WIRTH, *op. cit.*, p. 496.

¹⁴ WHITE, *op. cit.*

prises that necessitated a continuance of further advances from Europe until their completion. If Europe stopped the advances before the completion of the American railways, naturally the latter would remain unremunerative. The colossal drain exhausted the world's capital. The greatest promises of future returns were unable to call out the present goods. A time is reached in the inflation of credit when further production is no longer attractive, even if technically possible. The expansion has been so stimulated that no possible promised rate of returns can satisfy it. While the chief location of mere stock speculation was in Vienna, the place toward which large supplies of present goods were being drawn was the United States.

On the whole, if by "cause" of the crisis we mean those parts of the world where through experiments a change was occurring in the permanent environment of industry, the United States, with its extension of granger railroads, was undoubtedly the most important single country, although a similar movement was going on in Austria and Germany. The first *action*, however, was in Austria, and a succession of impulses was from there transferred to Italy, Russia, United States, Germany, and England. The psychic "cause" of the crisis was therefore in Vienna. The long-time cause, involving a change of permanent environment, was in the United States. Accordingly, therefore, as we interpret "cause" as short or long time, as relatively psychic or materialistic, we shall attribute the crisis to Vienna or to New York.

A mere money crisis, barring the case of government money, is one that can be allayed by prompt extension of bank credit. A money crisis is essentially a banking crisis, and is apt to be accompanied by runs on banks. Such a crisis may be caused by apprehension of a weakness of the banks due to their mismanagement. When apprehension is allayed the crisis is ended. A money crisis may be due to inflation not traceable to industrial promotion primarily, but to overexpansion of the banking business. This is not likely to occur unless there is a boom in banking, as in England and America before the crisis of 1837. But when there has been a general campaign of industrial promotion, although the banks are quite sure to be drawn into the movement, there will

follow a period of liquidation, which involves reconstruction of the industrial organization on new lines, and amounts to nothing less than a change to a new institutional environment.

While, therefore, we have what are known as capital crises, as distinguished from money crises, the former generally involve the latter. The fall of prices and the scramble for discounts and deposits would not have taken place if the bank inflation had not been caused by the craze of promotion. The causal chain is: overcapitalization; increase in nominal capital throughout the country, inducing banks unconsciously to expand their loans; a fall of prices due to cessation of the campaign for promotion; and a period of liquidation. There will always be a time in which there is an urgent demand for more loans, because the ones already made are so unsatisfactory. Similarly in the case of government paper issues, the more they depreciate, the more the public clamors for them.¹⁵ The legislature is urged to vote for the printing of more money, because the money already printed has so little value. But, apart from the question of government paper money, it cannot be too often repeated that the need of money in crises is an indirect but inexorable result of the preceding excessive stock issues. There is, however, no ready means of stopping the capital crisis like the simple remedy of liberal loaning in the money crisis.

The bank notes and government paper money of the world — what is commonly known as the credit circulation — was, estimated ¹⁶ at —

Period	Millions Marks
1846-50 (average) - - - -	2,000
1872-73 - - - -	9,000
1880 - - - -	6,900

Since 1880 was a good business year, it will be seen how great was the inflation in 1873; and the extent of the world credit movement will seem still greater when we add that not down to

¹⁵ SUMNER, *History of American Currency*, pp. 20, 219, *et passim*.

¹⁶ NEUMANN-SPALLART, *Uebersichten der Weltwirthschaft*, Vol. III, p. 292.

the last estimates of the Spallart-Juraschek series,¹⁷ including the year 1895, were the figures of 1873 equaled. Again, the uncovered bank paper of the world fluctuated as follows:¹⁸

Year							Millions Marks
1860	-	-	-	-	-	-	3,800
1873	-	-	-	-	-	-	7,914
1879	-	-		-	-	-	4,913

In two and a half years promotions and state loans, including the American conversions under the funding law of 1870, reached the enormous sum of thirty billions of marks.¹⁹

Turning to Austria again, where, as we have seen, was located the break of the credit structure, we find that the dealings on the Vienna bourse before the crisis rose to two million shares a day, or a sum of 450 million gulden, a larger business than that done on the New York Stock Exchange 1901-02.²⁰ The listings on the Vienna bourse rose from 152 at the beginning of 1857 to 605 at the beginning of 1874, and the frequenters of the bourse rose from 900 or 1,000 in the earlier year to 3,300 or 3,600 at the beginning of 1873. One of the worst forms of speculation was in city lots and buildings. A gardener in Vienna who, a few years before, had bought a little land for his business for 10,000 florins, sold it for 145,000. Both in Vienna and in Berlin the new buildings were designed for the use of the rich alone, with the result that rents were so raised for the poor that great numbers had to camp out before the doors of those cities, until driven away by the police. The empty apartments in Berlin decreased as follows:²¹

¹⁷ *Ibid.*, Vol. VI, p. lxxi. The fact that the gross paper money and note circulation was composed partly of depreciated government issues which have subsequently appreciated, diminishes the value of these statistics as evidence of the organic expansion. For an admission on this point *vide ibid.*, Vol. V, p. 448.

¹⁸ *Ibid.*, Vol. III, p. 295.

¹⁹ WIRTH, *op. cit.*, p. 472.

²⁰ Cf. SERENO S. PRATT, *The Work of Wall Street.*, p. 45.

²¹ GLAGAU, *Börsen und Gründungs Schwindel in Berlin*, p. 98.

Year								Empty
1867	-	-	-	-	-	-	-	8,000
1868	-	-	-	-	-	-	-	6,100
1869	-	-	-	-	-	-	-	3,500
1870	-	-	-	-	-	-	-	1,800
1871	-	-	-	-	-	-	-	2,000
1872	-	-	-	-	-	-	-	1,100
1873	-	-	-	-	-	-	-	800

But these apartments in 1873 were of the better class, which had gradually supplanted the homes of the poor. Their construction resulted in giving to the tenement-house problem the acute aspect just alluded to.

The Vienna fair of 1873 opened on May 1; on May 5 and 6 securities fell steadily; on May 7 the banks held a conference; on May 8 occurred a hundred failures in the bourse; on May 9 the whole speculative structure fell in with a crash that put all former panics in the shade.

On the days of May 8 and 9, 1873, the Vienna bourse was under a reign of terror. The tumultuous scenes of a revolution were enacted. The raging passion of the unfortunates beggared description. The keynote of those days was the rapid, headlong depreciation of an overwhelming majority of the securities listed. The business of the exchange stopped completely. Chaos reigned. Despair took possession of the speculators. On the day of the great crash many of the curbstone brookers seized the highly respectable "closet" bankers by the throat and shrieked with dying despair for the return of their all of which the promoters had robbed them. Others were bereft of reason by the sense of their horrible ruin and sought an end of misery in suicide.²²

Comparative statistics show a perfect "avalanche" of suicides in the years following the crisis of 1873.²³ But the great May crash in Vienna did not stop speculation in Berlin, where it kept on merrily for several months longer.

In Germany the essence of the crisis of 1873 lay evidently in overcapitalization. In his works on the promotion craze in Germany, Herr Otto Glagau cites hundreds of cases of the founding of enterprises of all sorts with capital estimated on a basis far above their cost or probable average returns. None of these cases, or almost none, involved anything like the idea of a trust or

²² WIRTH, *op. cit.*, p. 520.

²³ NEUMANN-SPALLART, *op. cit.*, Vol. III, p. 56.

industrial combination. That a concern in private hands, prosperous or otherwise, was turned into a corporation seemed of itself to be sufficient bait to the public. The German Limited Liability Act of 1870 allowed incorporation without special charters. In Austria new companies could be chartered only on permission of the government—an application which, in the period in question, was never refused. Like some American states of today, the Austrian government, impecunious as it has proverbially been, was unable to withstand the temptation of the large fees for incorporation. The size of the enterprises of those times, however, was so small as to be amusing to one accustomed to recent figures. The method of promotion, however, was the same then as now. In those days, the selling of a plant for 500,000 marks which cost 100,000, and then the capitalization of it for two or three millions, was a notable affair. When the depression came, no dividends were paid, and the stock became worthless, although very high dividends had been paid for a couple of years previously, or so long as it was possible to keep up the "bull" movement.

If iron and machine works were giving good returns, they had to be "promoted," and in this operation the basest dishonesty and trickery were practiced. Weighed down with enormous capitalization, and exposed to the robbery and plunder of their officials, the stock companies could never prosper. The prices of the products went up, and were systematically screwed higher. Demand appeared large, and was artificially further increased. The works were kept fully employed without regard to expenses, merely to keep the capital and the workmen busy, and consequently the product was enormous. As soon as the craze had disappeared, reaction took place. Demand stopped. Supply was urgent for sale. Stocks kept on increasing. Just as the prices of machines, engines, cars, rails, ties, etc., rose, they had to fall again, and they are still falling (1877) for they are not nearly low enough yet.²⁴

Some recommended a lowering of wages; others, a raising of iron duties; others claimed that the trouble was that the companies did not increase their capitalization and loans; while still others recommended the "writing off" of capital. "But," says Glagau, "even this last procedure could do no good, for the reason that it could not cause returns to appear where there were none,

²⁴ GLAGAU, *Börsen und Gründungs-Schwindel in Deutschland*, p. 114.

since, according to Daboll's arithmetic, ten times zero is only zero anyhow."²⁵

In Austria it was estimated that the cost of raising the money for building railroads amounted to from 25 to 30 per cent. of the 576 million gulden raised for that purpose, 1871 to 1873.²⁶ In many of the companies the directors coolly took the money that was being set aside for dividends and, instead of investing it in good bills or the like, used it for short speculation on the exchange.²⁷ The whole railroad speculation in that country was engineered by syndicates that founded the railroads only to speculate in stock. In order to further their plans, they tried to interest the old nobility of the land and induced it to lend its name as a bait to the public. In the directorates of the roads founded in Austria after 1866 there were thirteen princes, one landgrave, sixty-four counts, twenty-nine barons, and forty-one other nobles. A similar statement holds true of the banks and industrials. The officials of the railroads generally occupied themselves in feathering their own nests, and it is no wonder that corruption spread to the lowest ranks of employees, who could not help perceiving what their superiors were doing.²⁸ In Berlin many of the enterprises were twenty times overcapitalized. In the Flora the concession for selling beer was held by the president of the board of directors.²⁹

A general phenomenon which may be observed in the occurrence of most crises, and also at this time in Austria-Hungary, Germany, and other countries where stock speculation got the upper hand, was the declaration of fictitiously high dividends which were not justified by the actual state of the business.³⁰ The sale of stocks, from which these dividends were paid as much as from earnings, was furthered partly by buying up the public press and partly by fictitious purchases or "wash sales" on the exchange. When this was forbidden by law, the same purpose

²⁵ *Ibid.*, p. 119.

²⁶ WIRTH, *op. cit.*, p. 489.

²⁷ *Ibid.*, p. 502.

²⁸ *Ibid.*, p. 493; cf. GLAGAU, *Börsen und Gründungs-Schwindel in Berlin*, p. 191.

²⁹ GLAGAU, *Börsen und Gründungs-Schwindel in Deutschland*, p. 121.

³⁰ *Vide* MEADE, *Trust Finance*, p. 341, for the parallel of today.

was reached circuitously by the founding of new companies to take the stock of the old, or by making agreements to assure business with other companies. The requirement of paid-up capital was avoided, especially in Vienna, by founding new companies, the stock of which was paid up by the elder companies, which, in turn, marketed the stock of the younger companies to the public. Underwriting was not yet looked upon as legitimate; but no way has been discovered, then or since, to prevent it.

The creation of a row of institutions in order to guarantee each other was especially followed in the land speculation in Berlin. Of course, each of the institutions took a good percentage, and the same person or persons were interested in all. Foremost among these promoters was a certain Herr Quistorp. He is compared by Glagau to Napoleon Bonaparte, in that he created everything by himself and out of nothing. He promoted a suburb of Berlin called West End, beyond Charlottenburg on the road to Spandau, "on a barren, sterile height, exposed to every wind." Then the West End Company founded the Union Bank in Charlottenburg, and succeeded in interesting the queen dowager and other members of the royal family, nobility, and officialdom in the speculation. Quistorp built a house in Berlin behind the university, and from here he issued the following promotions: companies for files, tobacco, paper, cars, barrels, tools, chemicals, optical instruments, buildings, cabs, horsecars, steamboats, mines, and furnaces. As a result of these activities, the promoting bank paid dividends of 18 per cent. in 1871 and 19 per cent. in 1872. "He was looked upon as a regular 'Honest John' by those who suspected everybody else, and when finally his Union Bank failed, some people thought the end of the world had come. He was a veritable hero of promotion."³¹

Of all promoters the prince was the so-called Dr. Bethel Henry Strousberg. It is claimed that this smooth Attic appellation had been modified to satisfy the public taste from the original harsher Ionic of Baruch Hirsch Straussberg. After a checkered career he reached Berlin and played a great part as a promoter of railways.

³¹ GLAGAU, *Bören und Gründungs-Schwindel in Berlin*, p. 38; WIRTH, *op. cit.*, p. 568.

Within a few years he built a dozen in the most original manner. Naturally he had to use others' money ("for he himself had only debts"), and, what is more, he built them as badly as possible and as expensively as one can imagine. In this way he was soon reckoned to be worth 20 to 50 millions and given the name of a Croesus, a second Count of Monte Cristo. He kept writers and newspapers in his pay. All the papers contained anecdotes and notices of the "great doctor," his luxurious home, his generosity and beneficence, his plans and enterprises. His name was soon as often heard as von Bismarck's and it became a question which was the greater man. The show windows of the book and art stores were filled with his pictures and his biography. He was called "the man that buys everything;" but he had to become finally "the man that sells everything." It was not until 1873, when Strousberg was all through with his herculean task, that he was exposed in Parliament by Herr Lasker, who turned him into an anatomical preparation for a public discourse for the information of the promoters in Parliament. Strousberg went also into iron and steel manufacturing for railroads, and finally got into prison in Moscow, whither he had gone to raise money. One of his colleagues was banished to Siberia, but Strousberg was clever enough to get himself simply banished from Russia.³²

The methods employed in 1873 will be recognized as the same, almost down to the details, as those employed one hundred and fifty years earlier and thirty years later. Nothing is more instructive than to watch the same principles in operation in a different environment or in an earlier epoch. It will not be amiss, therefore, to paraphrase closely the analysis given by Glagau of the methods of promotion in Germany in 1873. The whole matter is made clear by a supposititious case:³³ Herr Flau has a factory worth perhaps 250,000 thalers. In view of the piping times of prosperity and the "peculiar circumstances," he asks and receives 400,000 for it. That is to say, he hands it over to promoter Baer, and gets only a certificate—a proceeding which amounts to what we call now giving an option. Baer assembles his friends

³² GLGAU, *Börsen und Gründungs-Schwindel in Deutschland*, p. 57.

³³ GLGAU, *Börsen und Gründungs-Schwindel in Berlin*, pp. 47 ff.

and assigns to them their parts. First, Wolf and Fuchs appear. The three found an industrial company, which they call "Vulcan," and duly acknowledge their proceedings before a notary public. Wolf and Fuchs really buy the factory from Flau. In their ostensible and official capacity they buy it from Baer for a respectable price, a million thalers, after having acknowledged before a notary their capital as 1,200,000 thalers. The 200,000 thalers is for "running capital" or active assets. Later, on the same day, and again in the presence of a notary public, the first stockholders' meeting of Vulcan takes place. Baer, Wolf, and Fuchs are present; and besides them four others, Fröhlich, Selig, Grün, and Gelb—seven altogether. These are the first stockholders of Vulcan. They have signed up for the full amount of the stock, and have ratified the purchase of the factory from its former owner, Flau, for a million thalers, and the payment of this sum to Baer; and then they proceed to choose a board of directors. All these proceedings are solemnly recorded by the notary public. Of course, really Flau has to pay Baer the difference, while the latter turns around and sells to the company.

The next proceeding is to deposit 1,200,000 thalers stock in the banking house of Israel Brothers. Of course, the first subscribers are merely dummies and pay nothing; but now we are getting to the real money men. Israel Brothers advance the 10 per cent. of the capital which the law exacts in cash, and now Vulcan can be registered as a regular legal company. In a few weeks the bankers succeed in selling the stock on the market, and of course take their commission, which, curiously enough, amounts to just 200,000 thalers. The probability is that Flau, the factory owner, who is being "promoted," does not even get his full 400,000 thalers, the price of his surreptitious sale to Baer; and there is no doubt that the 200,000 thalers active capital, being in the hands of the directors, will melt away in the first year's business like snow in April.³⁴ It is no wonder, then, that the stock, which was introduced on the bourse at 100, falls to 15 after Israel Brothers cease to support it, and that Vulcan, abandoned

³⁴ On the insufficiency of cash provision in recent promotion, *cf.* MEADE, *op. cit.*, p. 109 *et passim*.

by the promoters, must seek loans to keep agoing. Even if Flau is retained as superintendent of the factory, he will not run it with his former economy, for his object now will be to get a big salary, and to spend money in enlarging the plant and in making costly experiments—things he would not have done under more individualistic enterprise.

Leaving the company of our representative promoters, let us observe the methods of disposing of stock to the real final purchasers, in the palmy days of the German boom of 1871–73. Then as now, syndicates were formed to share the risk. These syndicates underwrote one another, and thereby guaranteed successively to each other higher and higher rates of quotation on the exchange. A case could be cited of four syndicates acting in this way, and in each of them the same individual was principally interested, so that, by continually selling and buying to and by himself, he of course got as many profits. But how were the high prices kept up on the stock exchange? The syndicates had guaranteed that they would be kept up. The banking house which conducted the operation introduced the stock on a certain day. A great appearance was made of bidding for it. The more humble members of the broker fraternity had been duly instructed to buy it in. Of course, they were mere dummies, but they got their fees just the same. Gradually, however, through newspaper articles and bankers' indorsements of the scheme, the real public was drawn in and genuine purchasers were found. When the stock had all been sold, the syndicates were no longer concerned in bidding it up, and it generally took a sudden fall.³⁵

The syndicate proceedings seem to have been practically identical with those of today. The chief difference that appears is that the promotions then were on a much smaller scale—always excepting Hercules Strousberg's railway schemes—and that the arguments for the great savings and economies from the promotion were not so elaborate then as they are now, for the reason

³⁵ For a cotemporaneous Robinsonade on promotion cf. "Autobiography of a Joint-Stock Company," *Blackwood's Magazine*, Vol. CXX, p. 96. For the present time, cf. CERDIC SAXON, "History of a Trust," *North American Review*, Vol. CLXXVIII, p. 186.

that the plans did not generally involve a combination of concerns and almost never laid any pretense to a monopoly of the market. The promoters seem to have relied almost exclusively upon the prevailing enthusiasm for speculation, and upon the opportunity that was afforded for it by the industrious stock-watering made possible by turning a private factory, that had hitherto attracted little attention because it had jogged along with the ups and downs of business, into a quasi-public corporation. To one looking over the long lists of promotions given by Glagau, the element of combination is conspicuously lacking. Existing businesses were incorporated outright at an enormous overvaluation.

Perhaps the chief difference between the speculation of Germany in 1873 and that of the United States in 1903 is that the American public of today requires more argument. It wants to be shown the advantages of combination, and, above all, it cannot be induced to purchase by such bare-faced manipulation on the exchange. The brokers that bid up the new stocks in Wall Street are not the greasy-haired, shiny-coated fellows of the Berlin of 1873. No creed, confession, or race can be singled out as an object of wrath of ruined speculators, although skill is called for to prevent one set of politicians from exploiting the stock-exchange methods at the expense of another set. It takes a skillful eye to distinguish the "wash sales" from the genuine sales on the New York Stock Exchange. Today promotion is really accompanied by combination and by an attempt at a control of the market in the interest of the investing public, whereas in 1873 almost the only attempt at combination was Strousberg's "General Railway Company," in which he attempted to regalanize his credit by repromoting all of his railway schemes in one combination. Thus far the comparison is in favor of 1903, but still the deadly parallel remains true yesterday, today, and it is to be feared forever, that the public will go into new enterprises only when an ingenious and colossal edifice of empty promises has been reared.³⁶

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³⁶ MEADE, *Trust Finance*, p. 352.